



INDIA

# IndiaVantage

YOUR VANTAGE POINT ON INDIA

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Tata's proposed acquisition of Corus marks a paradigm shift both for India and the mature economies of Europe and America. Indian companies are in a confident mood and are scouting global markets for acquisitions. As a result, India's FDI outflow could soon exceed its FDI inflow. In 2005-06, FDI outflow from India touched USD 4.5 billion, while inflow was USD 5.6 billion. (Source: *The Economic Times*, October 29, 2006)

As businesses cross boundaries, so will people. In this issue, we look at the regulatory implications of personnel movement across countries through an article on foreigners serving assignments in India. The people theme is rounded off with a piece on the effectiveness of the People Capability Maturity Model in workplaces.

We welcome your feedback and comments.

Russell Parera  
Chief Executive Officer  
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### 1. Regulatory Compliance for Expatriates in India

India is one of the world's fastest growing economies and the center of attraction for large multi-national companies. India's socio-economic culture is expatriate-friendly. However, expatriates visiting India would do well to keep abreast of the tax and regulatory requirements they would have to meet. Firstly, the type of visa to be obtained depends on the nature of visit. Any person visiting India for employment is required to obtain an employment visa. While applying for this visa, a secondment letter/employment agreement has to be submitted. Dependants can obtain a dependant multiple-entry visa. A business visa must be obtained for business trips. A visa cannot be changed from business to employment or vice versa. Therefore, it is important to obtain the correct visa.

Persons of Indian Origin (PIO), who hold a PIO card, are not required to obtain a visa. PIO means a foreign citizen (not being a citizen of Pakistan,

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## 3G in India: Implications for Operators



Bangladesh, and other countries specified by the Indian Government) if

- He/she held an Indian passport
- He/she or either of his/her parent or grandparent or great grandparent was born in and was permanently resident in India
- He/she is a spouse of an Indian citizen or a PIO.

On arriving in India, one would have to register with the regulatory authorities (Foreigner Registration Regional Officer), generally, if the period of stay is 180 days or more. Failure to register could lead to penal consequences, including deportation.

Thereafter, a Permanent Account Number (PAN) will have to be obtained from the Indian Revenue authorities. India follows the pay-as-you-earn system of taxation. Therefore, an employer is required to withhold tax and deposit the same with the government treasury and issue a withholding tax certificate to employees. Expatriates are required to file their annual personal tax return based on this certificate. In case of any income other than salary, the taxability of each component of income is examined.

After spending three to four years in India, a foreign citizen is liable to tax in

India on global income. India has entered into double taxation avoidance agreements with many countries, and appropriate relief from taxation can be claimed under these.

Indian revenue authorities are now focusing on revenue audit of expatriate tax returns; therefore, correct filing of returns with adequate disclosure is important.

Any default in tax and regulatory compliance could invite penal action. Hence, correct and timely advice in meeting compliance requirements and appropriate planning is a prerequisite for any expatriate assignment.

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### 2. 3G in India: Implications for Operators

On September 27, 2006, the Telecom Regulatory Authority of India (TRAI) issued its recommendations for the allocation of spectrum for 3G services.

TRAI recommended an initial fee to be decided through auctions of spectrum

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## *3G in India: Implications for Operators*



to ensure efficient utilization. In this regard, the approach adopted can be compared with European countries and contrasted with Japan and South Korea. It is pertinent to note that the growth of 3G has been faster in Japan/South Korea, and the key driver of this growth has been affordability of the service to the end consumer. Prices for 3G services in Europe are higher due to recovery of license cost from the subscribers.

India is the fifth largest telecom market in the world with a mobile subscriber base of 123 million as of August 2006; it is expected to overtake Japan by 2010 to become the third largest mobile market. The success of 3G and its early adoption by consumers will depend upon the tariffs of services (operator driven), availability of sub-USD 100 devices (manufacturer driven), and quality of content (content provider driven).

For operators, the road ahead is steep. Not only do they have to incur heavy capital expenditure on license fees and upgradation/deployment of 3G-enabled networks, they also have to ensure that tariffs remain affordable, implying that in the short run, they will have to subsidize 3G to achieve higher average revenue per user in the medium term.

Expansion will be financed either by consolidation through mergers and

acquisitions or foreign direct investment in the telecom sector. Operators will have to develop an appetite for short-term losses to sustain operations in the medium term. To reduce the impact of short-term losses, operators will have to take substantial measures to enhance the margins from their existing portfolio of services. Margin enhancement and cost management will become the mantras for success. Operators will have to strengthen their project management expertise to ensure quick and efficient deployment of 3G networks to achieve the targeted time to market.

A lot will depend on how operators position their services to targeted segments of the market. Substantial investments will be made in the marketing of services to ensure acquisition of a critical mass of customers.

Launch of 3G services is expected in early 2008. In the interim, expect a lot of activity in the Indian telecom space.

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## *The Indian IT Industry—Tax 'Bytes'*



### **3. The Indian IT Industry—Tax 'Bytes'**

The Indian Information Technology (IT) and IT-enabled Services (ITeS) industry continues to chart a remarkable double-digit growth, and is expected to clock around USD 36 billion in revenues, in 2006. Buoyed by a string of high-growth years, the industry has set itself an ambitious target of USD 60 billion in exports by 2010.

A supportive fiscal policy has been one of the driving factors for the growth of this sector. However, of late, the growing gap between the policymakers and the administration has left the industry grappling with various issues, some of which are listed below.

- a) The tax holiday under section 10A/10B of the Income-tax Act, 1961 (the Act), expires after March 31, 2009; no roadmap has been laid down for existing units thereafter.
- b) Though the government has announced a tax holiday scheme for units in Special Economic Zones (SEZs), there is no clarity on the migration of existing units to SEZs.
- c) It is not clear how small businesses will benefit from the SEZ package.
- d) There is a tendency towards examining how units claiming the tax holiday are formed, specifically whether the unit

- Was formed by splitting-up or reconstructing an existing business
  - Was formed by transferring used plant and machinery
  - Commenced its business as an approved unit.
- e) Authorities have taken differing views on concepts like 'total turnover', 'export turnover', and 'expenditure attributable to delivery of software', which are relevant for quantifying tax deduction. For instance, lease line charges are treated as expenditure attributable to delivery of software, without keeping in mind that at least some part of it would be attributable to inward communication, and only a portion can be related to actual software delivery.
  - f) Though there have been recent tax tribunal decisions on the issue of withholding taxes from payments made towards purchase of software and connectivity charges paid outside India, these have not been applied uniformly
  - g) There have been concerns on the method of accounting employed and the availability of tax benefit on unbilled revenues, typical to the software industry.
  - h) Although two transfer pricing audits have been completed, there

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## *Indirect Tax Issues in the Telecommunications Industry*



is no consensus on 'safe harbor' provisions, i.e., a cut-off margin that could be considered to be at arm's length with regard to pure captive units.

To date, this sector has flourished with little government intervention, on the basis of excellent entrepreneurial skills. To maintain its leadership in the services sector, India needs a stable fiscal policy and not sporadic tax incentive schemes that can be tweaked by every Finance Act.

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### **4. Indirect Tax Issues in the Telecommunications Industry**

The telecommunications industry has emerged as a significant contributor to the economy. This has brought it under the purview of a plethora of indirect taxes. Constant changes in indirect taxes have only complicated the issue, leading to litigations and disputes. Some of the issues that have

generated ambiguity are discussed below.

#### **Goods or Services**

Till recently, the industry's biggest concern was whether providing telephone connections would qualify as sale of goods. However, in a recent judgment, the Supreme Court held that such services will not qualify as goods. With respect to SIM cards, the court ruled that a transaction may qualify as 'sale' of goods or 'provision' of services depending on the intent of transaction. This has generated debate on how 'intent' is to be determined and whether transactions such as re-charge vouchers, ring tones, and other value-added offerings could also qualify as sale of 'goods'.

#### **Export/Import of Services**

The introduction of rules and conditions on place of supply and delivery as criteria for qualifying as export/import of services has resulted in fresh challenges.

For instance, if services are rendered to a recipient located outside India and also 'delivered' and 'used' outside, it would qualify as 'export' (and would hence not be liable to service tax). Now, consider the following situation: An offshore telecom operator has entered into a contract with an Indian counterpart for providing bandwidth in

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## *Business Impact Through the People Capability Maturity Model*



India (for end-to-end connectivity for its overseas clients). Does the bandwidth provided by the Indian telecom operator qualify as export of services, given that the bandwidth and services will be utilized by both Indian and off-shore entities? In other words, can the services be said to be 'delivered' and 'used' outside India?

### **Applicability of Service Tax**

The industry has many inter-operator revenue streams, such as inter-connect link charges, access/usage charges, etc. Applicability of service tax on these has been a matter of dispute.

These issues require careful analysis and deliberations. The manner of executing the transaction and the documents representing the transaction are important to ascertain the precise implications.

It is also important that industry and government collaborate to ensure that tax laws are simple, unambiguous, and in consonance with technological advancements.

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### **5. Business Impact Through the People Capability Maturity Model**

Organizations have started realizing that business results depend largely on the quality of their workforce. Process improvement initiatives like ISO, CMMI, and Six Sigma are incomplete unless the people component is addressed.

The People Capability Maturity Model (PCMM), developed by the Software Engineering Institute (SEI) of Carnegie Mellon University, provides a framework for building the organizational capability to manage the workforce.

### **Current scenario**

As per SEI's PCMM Maturity Profile released in January 2006, 83 PCMM assessments have been conducted. Of these, 39 were in the U.S., 37 in India, and the rest in Europe, Canada, and Korea. The PCMM framework has been adopted and applied extensively by Information Technology (IT) players in India.

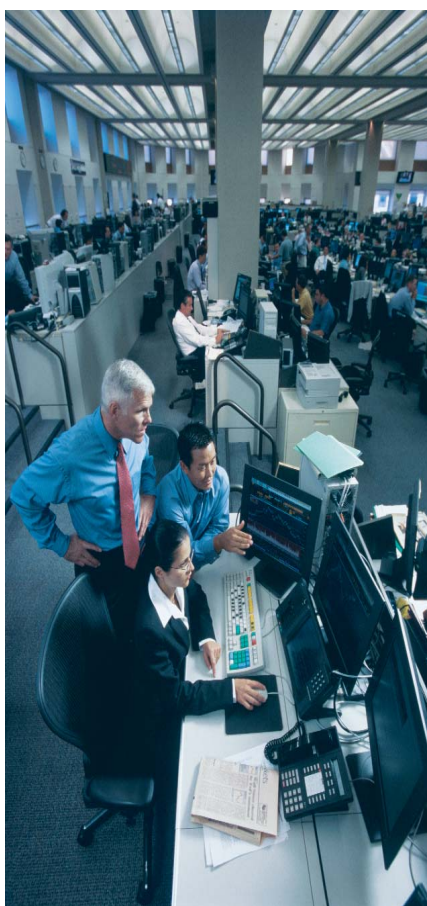
### **How PCMM helps**

PCMM facilitates the implementation of increasingly sophisticated workforce practices across five maturity levels. Workforce practices are revolutionized with the evolution of the PCMM-based competency framework. Small- and medium-sized Indian organizations

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experienced the impact of team competencies in the enhancement of operational efficiency. Strategic HR scorecards have been used to align competencies related to customer relationships, learning and growth perspectives, and financial and operational perspectives to organizational goals as per the Balanced Scorecard framework.

The appraisal results show that organizations adopting PCMM have been able to experience 15-20 percent reduction in attrition rates due to effective employee development and motivational programs. In a PCMM environment, employees were able to relate their career aspirations to the business goals of the organization. The employee satisfaction index improved drastically due to the ongoing communication between the senior management and employees. Above all, organizations have been able to demonstrate lifetime employability rather than mere lifetime employment.

### **Conclusion**

PCMM as a model is not restricted to a particular sector such as IT and can be extended to other sectors as well. IT-enabled Services, business process outsourcing, manufacturing, retail, healthcare, and pharmaceutical sectors have now started adopting this framework to overcome challenges in talent attraction, retention, and development.

Organizations with good workforce practices have consistently outperformed others in profitability and sales. Customer satisfaction is directly proportional to talent management.

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**About IndiaVantage:**

IndiaVantage is an India-focused, bi-monthly, freely-distributable newsletter brought out by the Knowledge Management team of KPMG in India.

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